

Message Text

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AMEMBASSY DUBLIN
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1. ITALY'S GENERAL POLICY TOWARD INWARD FOREIGN INVESTMENT
HAS BEEN CONSISTENTLY FAVORABLE, MOTIVATED BY THE BELIEF
THAT FOREIGN INVESTMENT CONTRIBUTES TO ECONOMIC GROWTH,
EMPLOYMENT, AND THE LEVEL OF TECHNOLOGY. FOREIGN INVESTMENT
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IN ITALY IS, IN PRINCIPLE, GOVERNED BY LAW NO. 43 OF FEBRUARY
7, 1956 AND SUBSEQUENT IMPLEMENTING REGULATIONS. LAW 43
GUARANTEES REPATRIATION OF FOREIGN CAPITAL ORIGINALLY INVESTED
IN NEW "PRODUCTIVE" ENTERPRISES IN ITALY AND UNLIMITED REMIT-
TANCE OF PROFITS THEREFROM. ("PRODUCTIVE" INVESTMENTS MAY
BE DEFINED AS THOSE ADDING TO ITALY'S STOCK OF PHYSICAL CA-
PITAL). FOREIGN INWARD DIRECT INVESTMENT TRANSACTIONS AND

TRANSFERS ARE ALSO COVERED BY ITALIAN EXCHANGE CONTROL PROCEDURES. ALTHOUGH BOTH CAPITAL AND EARNINGS ARE FREE OF RESTRICTIONS, THE EMBASSY HAS NOTED SOME INSTANCES DURING THE PAST YEAR WHEN STRICT ENFORCEMENT OF EXCHANGE CONTROLS MAY HAVE CAUSED SOME ADMINISTRATIVE DELAYS IN EFFECTING CERTAIN INTERNATIONAL TRANSFERS OF FUNDS. THE GOVERNMENT'S RESTRICTIVE POLICY ON ISSUING WORK PERMITS TO FOREIGNERS MAY ALSO BEAR ADVERSELY ON FOREIGN INVESTMENTS. ANOTHER INHIBITING FACTOR IS THE MULTIPLICITY OF PERMITS, REGISTRATION AND OTHER REQUIREMENTS NECESSARY TO COMMENCE OPERATIONS. DELAYS OF THE BUREAUCRACY IN DEALING WITH THESE MATTERS CAN CAUSE PROBLEMS FOR BUSINESSES--ESPECIALLY IN RAPIDLY CHANGING TECHNOLOGIES.

2. IN GENERAL ITALY DOES NOT LIMIT THE EXTENT OF FOREIGN OWNERSHIP IN AN ITALIAN CORPORATION OR OTHER BUSINESS ENTITY, AND ONCE ESTABLISHED IN ITALY, THE ITALIAN GOVERNMENT'S STANCE ON FOREIGN INVESTMENT IS NATIONAL TREATMENT; THAT IS, NON-DISCRIMINATORY EITHER IN FAVOR OR AGAINST FOREIGN INVESTMENT, AS COMPARED WITH DOMESTIC INVESTMENT. THERE ARE SOME RESTRICTIONS, HOWEVER, ON MEDIUM AND LONG-TERM INDEBTEDNESS IN LIRA OF FOREIGN OWNED FIRMS THAT WISH TO BE ELIGIBLE FOR THE TRANSFER GUARANTEES UNDER LAW 43. US BUSINESS SOURCES IN ITALY HAVE ADVISED THAT THIS RESTRICTION HAS NEVER BEEN APPLIED ON REMITTANCES OF PROFITS, BUT FEEL THAT THEY WOULD BE APPLIED ON REPATRIATION OF CAPITAL IF THEY DECIDED TO WIND UP THEIR ITALIAN OPERATIONS. SUCH RESTRICTIONS ON LOCAL BORROWING

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COULD BE ONEROUS DURING PERIODS OF HIGH INFLATION OR LIRA DEPRECIATION WHEN FOREIGN INVESTORS WOULD WANT TO MINIMIZE THEIR NET ASSET EXPOSURE IN LIRE.

3. LEGISLATION HAS BEEN IN EFFECT IN ITALY SINCE 1950 THAT PROVIDES FOR INCENTIVES DESIGNED TO STIMULATE ECONOMIC DEVELOPMENT IN SOUTHERN ITALY. THESE INCENTIVES CONSIST MAINLY OF TAX EXEMPTIONS, GRANTS, SOFT LOANS, AND TEMPORARY EXEMPTION FROM THE SHARE OF PAYMENTS INTO THE PENSION FUND REQUIRED TO BE MADE BY EMPLOYERS. THEY ARE EXTENDED UNIFORMLY, WITHOUT DISCRIMINATION, TO BOTH DOMESTIC AND FOREIGN INVESTORS. SIMILAR, BUT SOMEWHAT LESS GENEROUS, INCENTIVES ARE AVAILABLE FOR DOMESTIC AND FOREIGN INVESTMENTS IN DEPRESSED AREAS IN CENTRAL AND NORTHERN ITALY.

4. MULTINATIONAL FIRMS, WHICH ARE GENERALLY CAPITAL INTENSIVE, HAVE BENEFITTED FULLY FROM THESE INCENTIVE PROGRAMS. LAW NO. 183 FOR THE ECONOMIC DEVELOPMENT OF SOUTHERN ITALY OF MAY 2, 1976, HAS AMENDED THE REGULATIONS ON LOANS AND GRANTS, HOWEVER, IN SUCH A MANNER AS TO FAVOR THE SMALL AND MEDIUM-SIZED LABOR-INTENSIVE ENTERPRISES. THE TAX INCENTIVES AND THE EXEMPTION FROM PENSION-FUND PAYMENTS CONTINUE TO BE GRANTED

UNIFORMLY TO BOTH LABOR-INTENSIVE AND CAPITAL-INTENSIVE FIRMS.

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5. THE BASIC ECONOMIC CONSIDERATIONS THAT WOULD BE EXPECTED TO BEAR ON FOREIGN INVESTMENT IN ITALY ARE THE SAME AS THOSE AFFECTING ITALIAN INVESTMENT IN GENERAL; THESE ARE THE RATE OF RETURN OR PROFITABILITY OF INVESTMENT AND THE DEGREE OF UNCERTAINTY ASSOCIATED WITH ITS PROFITABILITY. BOTH OF THESE FACTORS HAVE CONTRIBUTED TO INVESTMENT WEAKNESS IN ITALY DURING THE RECENT PERIOD AND TO A DECLINING TREND IN FOREIGN INVESTMENT. AN INDICATION OF THE REDUCTION IN PROFITABILITY OF INVESTMENT IN ITALY IS THE CONTINUAL FALL IN THE SHARE OF PROFITS AND RISE IN THE SHARE OF WAGES IN NATIONAL INCOME SINCE 1970. THE MAIN REASON FOR THIS SHIFT FROM PROFITS TO WAGES HAS BEEN THE RAPID RISE IN REAL WAGES, WHICH HAS, IN TURN, CAUSED UNIT LABOR COSTS TO RISE FASTER THAN SELLING PRICES. DURING THE RECENT PERIOD INVESTMENT IN ITALY HAS THEREFORE CONSISTED LARGELY

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OF INVESTMENT IN LABOR-SAVING MACHINERY AND EQUIPMENT RATHER THAN IN PLANT EXPANSION. IN ADDITION TO THE RAPID RISE IN LABOR COSTS, HIGH RATES OF INFLATION SINCE 1973 AND LIRA DEPRECIATION, AS DURING THE FOREIGN EXCHANGE MARKET CRISIS IN 1976, HAVE INCREASED THE DEGREE OF UNCERTAINTY ABOUT PROFITABILITY, RELATIVE TO THE PREVIOUS PERIOD AND PERHAPS ALSO RELATIVE TO THAT PREVAILING IN OTHER INDUSTRIAL COUNTRIES. THESE FACTORS HAVE AFFECTED BUSINESS CONFIDENCE DIRECTLY THROUGH THEIR IMPACT ON RELATIVE PRICES AND INDIRECTLY BECAUSE OF THE ECONOMIC POLICY RESPONSES THEY HAVE INDUCED. IN ORDER TO BRING DOWN INFLATION AND CORRECT THE BALANCE OF PAYMENTS SITUATION, THE ITALIAN AUTHORITIES HAVE HAD TO DEPEND ON STRONG DEFLATIONARY PROGRAMS USING BOTH MONETARY AND FISCAL MEASURES. SUCH PROGRAMS WERE PUT INTO EFFECT IN 1974 AND 1976-77, ONE OF THE UNDESIRABLE, IF UNAVOIDABLE, CONSEQUENCES OF THESE STABILIZATION PROGRAMS WAS A SHARP REDUCTION IN INVESTMENT.

6. AS IMPLIED IN PARAGRAPH 5, ITALIAN LABOR UNIONS THROUGHOUT THE LAST DECADE HAVE CONSISTENTLY OBTAINED SUBSTANTIAL INCREASES IN REAL WAGES, CAUSING LABOR COSTS TO RISE MORE RAPIDLY THAN IN THE OTHER INDUSTRIAL COUNTRIES. ITALIAN LAW AND UNION CONTRACTS ALSO SEVERELY CIRCUMSCRIBE MANAGEMENT'S ABILITY TO LAY OFF OR DISMISS EMPLOYEES. A NUMBER OF ITALIAN FIRMS ARE CURRENTLY HAVING DIFFICULTY (E.G., PLANT OCCUPATIONS AND LENGTHY NEGOTIATIONS WITH GOVERNMENT AND UNIONS) IN ATTEMPTING TO REDUCE THEIR WORK FORCES TO LEVELS CONSISTENT WITH ECONOMIC VIABILITY. HOWEVER, UNION LEADERS INCREASINGLY RECOGNIZE THAT EXCESSIVE WAGE INCREASES AND LABOR IMMOBILITY DISCOURAGE INVESTMENT AND PREVENT EXPANSION OF EMPLOYMENT, AND ITALY'S GROWING UNEMPLOYMENT HAS RECENTLY BECOME LABOR'S MAIN STATED CONCERN. THUS, THE OUTLOOK IS IMPROVED FOR UNION RESTRAINT ON WAGES AND UNION

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FLEXIBILITY IN ALLOWING INCREASED LABOR MOBILITY. LABOR IS EXPECTED, HOWEVER, TO TIE ANY CONCESSIONS IN THESE AREAS TO INCREASED DEMANDS FOR DEFINITE INVESTMENT AND EMPLOYMENT COMMITMENTS BY FIRMS, WHICH WILL WORSEN PROBLEMS IN THIS AREA OF LABOR-MANAGEMENT RELATIONS.

7. TOTAL FOREIGN DIRECT INVESTMENT IN ITALY DECLINED IN 1976 TO 5,035 BILLION LIRE FROM 5,722 BILLION LIRE AS OF THE END OF 1975, ACCORDING TO THE BANK OF ITALY ANNUAL REPORT OF 1976. DOLLARS, THE DROP WAS TO \$6.1 BILLION IN 1976 FROM \$8.8 BILLION IN 1975, CONVERTED AT END OF YEAR EXCHANGE RATE OF 832 AND 653 LIRE PER DOLLAR, RESPECTIVELY.

THIS DROP IS ATTRIBUTABLE ENTIRELY TO A DROP IN DIRECT INVESTMENT FROM SWITZERLAND, LUXEMBOURG AND LIECHTENSTEIN, THE SO-CALLED INTERMEDIARY OR "PASS THROUGH" COUNTRIES, AND MUST BE LARGELY ATTRIBUTED, IN TURN, TO THE RENATIONALIZATION OF DISGUISED "FOREIGN" INVESTMENT BY ITALIANS UNDER THE EFFECTS OF LAW NO. 159 AND THE TEMPORARY AMNESTY THEREFROM.

8. ACCORDING TO THE "SURVEY OF CURRENT BUSINESS" (AUGUST 1977), US DIRECT INVESTMENT IN ITALY INCREASED TO \$2,944 MILLION FROM \$2,679 MILLION, OR BY ABOUT 10 PERCENT IN 1976. THIS INCREASE OF \$256 MILLION CONSISTED OF NET CAPITAL INFLOWS OF \$176 MILLION AND REINVESTED EARNINGS OF ABOUT \$80 MILLION. (THE REMAINDER IS ATTRIBUTABLE TO VALUATION ADJUSTMENTS.) THE BULK OF THE NET CAPITAL INFLOW WAS IN THE TRADE SECTOR. US DIRECT INVESTMENT IN ITALY RECOVERED RATHER SHARPLY IN 1976 COMPARED TO 1975, WHEN IT WAS UNCHANGED AND THERE WAS DISINVESTMENT. (REINVESTED EARNINGS WERE NEGATIVE). IT APPEARS THAT, IN TERMS OF US DIRECT INVESTMENT, ITALY IS IN SIXTH PLACE IN EUROPE. GARDNER

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